

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF OHIO COUNTY WATER)	
DISTRICT FOR (1) ISSUANCE OF A)	
CERTIFICATE OF PUBLIC CONVENIENCE AND)	
NECESSITY FOR CONSTRUCTION OF THE)	
1997 WATER SYSTEM IMPROVEMENTS; (2))	CASE NO. 98-015
AUTHORIZATION TO ISSUE SERIES I)	
REVENUE BONDS IN THE AMOUNT OF)	
\$4,000,000; AND AUTHORIZATION TO RAISE)	
RATES TO PAY FOR THE ADDITIONAL)	
INDEBTEDNESS)	

O R D E R

On February 13, 1998,¹ Ohio County Water District applied to the Commission for a Certificate of Public Convenience and Necessity to construct certain facilities, authority to issue \$4.0 million in revenue bonds and authority to increase its rates for water service. The proposed rates would increase normalized annual water revenues of \$1,599,797 by approximately \$456,231, an increase of 28.5 percent. This Order grants the requested Certificate, authorizes the proposed bond issuance, and grants an increase in annual water revenues of \$240,844, an increase of 15.1 percent.

¹ Ohio District filed its Application with the Commission on January 7, 1998. The application, however, did not comply with Administrative Regulation 807 KAR 5:001 and was not accepted for filing. Ohio District cured its filing deficiencies with a subsequent filing on February 13, 1998.

On March 27, 1998, the Commission consolidated Case No. 97-423² with this proceeding. Case No. 97-423 involved an investigation of the allegations of the Green River Regional Poultry Association ("Poultry Association") that Ohio District's existing rate structure failed to reflect the dramatic increase in poultry operations in Ohio District's service territory and impeded economic development. Prior to the consolidation of these cases, the Commission had permitted the Poultry Association to intervene in this proceeding.

After conducting extensive discovery in this proceeding, the Commission held a public hearing on Ohio District's application on July 29, 1998. Following Ohio District's submission on August 4, 1998 of certain information requested at this hearing, this case stood submitted for decision.

COMMENTARY

Ohio District is a water district organized pursuant to the provisions of KRS Chapter 74. It serves approximately 3,903 customers in a five county area. It provides retail water service to customers residing in Ohio, Daviess, Grayson, McLean and Butler counties, Kentucky and wholesale water service to Beaver Dam and Fordsville, Kentucky.

PROPOSED CONSTRUCTION

Background

Ohio District currently experiences low pressure in several areas of its distribution system. These problems are caused by inadequately sized distribution mains, terrain

² Case No. 97-423, An Investigation Into the Rates of Ohio County Water District (October 21, 1997) (Order initiating investigation).

features, and inadequate water storage. The sudden and swift development of the poultry industry in western Kentucky has increased the demand for water and further exacerbated these problems. On March 31, 1997, the Natural Resources and Environmental Protection Cabinet ("NREPC") imposed a water line extension and tap-on ban on Ohio District.³ Further compounding these problems is the widespread contamination of well water within certain areas of Ohio District that has raised calls for the immediate extension of water mains to the affected areas.

To correct these conditions, Ohio District has developed a long-range plan of water system improvements.⁴ It proposes to construct these improvements, which it currently estimates to cost \$9.5 million, in three phases over the next three years. Improvements in each phase would be financed through separate bond issuances. None of the issuances would exceed \$4.0 million. The Ohio County Fiscal Court has pledged an additional \$700,000 in funding to support these improvements.

An integral part of Ohio District's improvement plans is the water treatment facilities of Perdue Farms, Inc. ("Perdue Farms"). In 1995 Perdue Farms constructed a water treatment facility with a 3 million gallon per day ("MGD") capacity. As part of its agreement with certain local governments for certain financial incentives, Perdue Farms agreed to

³ Letter from Vicki L. Ray, Manager, Drinking Water Branch, Division of Water, NREPC, to James Porter, General Manager, Ohio County Water District (March 31, 1997). See Case No. 97-423, Ohio District's Response to the Commission's Order of October 21, 1997, Item 9 at 10. On July 25, 1997, the NREPC modified this ban to permit tap-ons for all residential uses. The ban continues to apply to industrial, commercial, and agricultural applications. Id. at 11.

⁴ See Case No. 98-015, Ohio District's Application, Exhibit M.

provide 1 MGD of water to Ohio County Fiscal Court at no cost for 12 years. Ohio County Fiscal Court in turn has agreed to provide this water to Ohio District.⁵ Ohio District intends to connect its distribution facilities to Perdue Farms' water treatment facilities to use this additional water. With the availability of this additional capacity, Ohio District will have an adequate supply to extend service throughout its service area. As a condition to obtaining this additional capacity from Ohio County Fiscal Court, Ohio District has agreed to make water main extensions to certain areas within Ohio County.

Series I Improvements

Ohio District's application covers the first phase of the proposed system improvements. The Series I Improvements are divided into 6 water improvement projects.⁶ Total project cost, excluding engineering, easement, administrative, legal, financing and contingency costs, is \$2,674,937.⁷ These projects are:

⁵ See Case No. 97-423, Ohio District's Response to the Commission's Order of October 21, 1997, Item 3 at 8. This commitment is in the form of a motion adopted by Ohio Fiscal Court. Ohio District considers this resolution to form a binding commitment. No written agreement between the two entities exists. See Case No. 98-015, Ohio District's Response to the Commission's Order of June 9, 1998, Item 10.

⁶ After the public hearing on its application, Ohio District sought to include an additional project, Contract G, in the Series I Improvements. Compare Case No. 98-015, Ohio District's Response to Hearing Requests ("Exhibit R"), Item 5 at 2-3 with Case No. 98-015, Ohio District's Response to the Commission's Order of June 9, 1998, Item 1. No motion to amend the original application to include Contract G has been made. For purposes of this Order, therefore, all references to "Series I Improvements" exclude Contract G.

⁷ For an itemized schedule of the costs of each improvement project, see Case No. 98-015, Ohio District's Response to Hearing Requests ("Exhibit R"), Item 6 at 2-4.

- Contract A. This contract involves the installation of 59,740 feet of 4-inch and 8-inch water mains to improve the hydraulics of the Ohio District distribution system and will not immediately serve any new customers. Total construction cost is \$323,039.
- Contract B. This contract involves the installation of 37,060 feet of 4-inch, 6-inch and 8-inch water mains. Its purpose is to improve the hydraulics of the Ohio District distribution system and will not immediately serve any new customers. Total construction cost is \$265,089.
- Contract C. This contract involves the installation of 59,455 feet of 4-inch, 12-inch, 16-inch and 18-inch water mains. This project includes a main transmission line to connect the Perdue Farms' facilities to a new water storage tank in the northern portion of Ohio District's system. Total construction cost is \$973,409.
- Contract D. This contract involves the construction of two 500,000 gallon elevated water storage tanks. Total cost is \$821,100.
- Contract E. This contract involves the construction and installation of pumping facilities at the Perdue Farms water treatment plant. Estimated construction cost of these facilities is \$162,300.
- Contract F. This contract involves the installation of radio control telemetry and equipment to operate the pumps and tanks throughout Ohio District's system. Estimated construction cost of these facilities is \$130,000.

The Commission finds that a Certificate of Public Convenience and Necessity should be granted for Series I Improvement Project Contracts A through F. NREPC has reviewed and approved the drawings and specifications for each project. The proposed construction is necessary to improve Ohio District's hydraulic operating conditions, will permit the removal of the tap-on ban, and extend water service to previously unserved areas. All are necessary for the provision of adequate and reliable water.

By our action this day, the Commission has taken the unusual step of issuing a Certificate of Public Convenience and Necessity for projects for which final bids have yet

to be submitted. Ohio District did not advertise for bids on Contracts E and F until August 10, 1998 and does not expect to receive bids until August 27, 1998. Historically, the Commission has refused to issue a Certificate until the final bids on a project have been received and analyzed. We make an exception in this case because the projects are direly needed, the plans and specifications for these projects have been fully reviewed, and the estimated project costs appear reasonable. Moreover, by limiting the use of the proceeds from the revenue bond issuance, the danger that Ohio District will improperly use any excess proceeds has been significantly reduced.⁸ The Commission cautions Ohio District, however, that in future proceedings no improvement project will be issued a Certificate until the submission of final bids. The Commission strongly encourages Ohio District to place greater attention in its planning process on the timing requirements for the design of its proposed projects and for the regulatory review of such projects.

Contract G

Following the public hearing in this case, Ohio District submitted the proposed plans and specifications for an additional project – Contract G. It has also amended several of its prior exhibits to reflect the addition of this project to the Series I Improvements Projects. Until August 4, 1998, Ohio District had not listed this project as a Series I Improvements Project. As of August 4, Ohio District had not issued bids on Contract G nor did it expect

⁸ Because Ohio District plans to return to the Commission in 1999 for approval of additional construction projects and the rates and financing to support that construction, the effect of any variances in the estimated cost of the proposed projects and the actual cost is significantly reduced. Any deviation between the estimated cost and the actual cost can be addressed in that future proceeding.

to receive such bids until after the expected date of the Commission's decision on its application.⁹

As Ohio District has never moved to amend its application to reflect the addition of Contract G, the Commission finds that Contract G should not be considered as part of the Series I Improvements and should not be considered with this case. The utility should file a separate application for a Certificate of Public Convenience and Necessity with the Commission and include in that application all required information.

PROPOSED FINANCING

Ohio District seeks authorization to issue \$4.0 million in revenue bonds. The Series I Improvement Bonds will mature in various annual amounts through 2028. Estimated interest rates will range serially from 4 percent increasing to 6 percent in the final year. The average interest rate for this issuance is estimated at 5.75 percent. The proceeds of the proposed bond issuance will finance the proposed Series I Improvement Projects. The Commission finds that the proposed bond issuance is consistent with the proper provision of utility service and should be authorized.

The Commission places Ohio District on notice that the proceeds of the proposed bond issuance should not be used for any water system improvement project other than the Series I Improvement Project Contracts A through F. Should any proceeds from this issuance remain after the completion of Contracts A through F, Ohio District may apply to the Commission for approval to apply these proceeds to other projects. Such application

⁹ See Ohio District's Response to Hearing Requests ("Exhibit R"), Item 5 at 2.

should be part of any application for a Certificate of Public Convenience and Necessity for these other projects.

TEST PERIOD

Ohio District has proposed and the Commission accepts the 12-month period ending September 30, 1997 as the test-period for determining the proposed reasonableness of the proposed rates. In using this historic test period, the Commission has given full consideration to appropriate known and measurable changes.

REVENUES AND EXPENSES

Ohio District reported test-period income from water sales as \$1,451,178 and operating expenses of \$1,278,778, which it proposes to adjust to \$1,649,634 and \$1,384,427, respectively. Ohio District has proposed several adjustments to test-year operations to normalize current operating conditions. The Commission finds that, with the exceptions noted below, these adjustments are reasonable and in accordance with accepted rate-making practices.

Purchased Water Expense

Ohio District reported actual test period purchased water expense of \$3,767. Ohio District states that this expense is a non-recurring expenditure.¹⁰ This expense, therefore, has been disallowed for rate-making purposes.

¹⁰ Ohio District's Response to the Commission's Order of June 9, 1998 ("Exhibit Q"), Item 24.

Chemical Expense

During the test period, Ohio District experienced a 61 percent increase in its chemical expense. It attributed this increase to "problems with filters clogging prematurely" and noted that it was experimenting with different chemicals and different chemical dosages to "optimize operation."¹¹ During the hearing in this matter, Ohio District's General Manager testified that only recently has the water district reached the optimum level of operation.¹² Following the hearing, Ohio District submitted chemical usage levels for the first 6 months of 1998. Based upon these levels, Ohio District estimates an annual chemical expense of \$55,882.¹³ Despite this estimate, the utility proposes the use of a pro forma chemical expense of \$110,000. Finding no basis to support the proposed chemical expense, the Commission rejects Ohio District's proposal and reduces annualized chemical expense by \$79,511 to reflect current annualized chemical usage.

Materials and Supplies

Ohio District had test period material and supplies expense of \$73,368. This amount includes \$14,620 of capital and non-recurring expenditures for distribution lines, meter installations, a tripod, and pump repairs. Therefore, this expense has been reduced by \$14,620.

¹¹ Ohio District's Response to the Commission's Order of June 9, 1998 ("Exhibit Q"), Item 25; Ohio District's Response to the Commission's Order of May 8, 1998 ("Exhibit P"), Item 7.

¹² Transcript at 25 – 28.

¹³ Ohio District's Response to Hearing Requests ("Exhibit R"), Item 3 at 2.

Contractual Services Expense

Ohio District had test period contractual services expense of \$85,022. The Commission has reduced this amount by \$45,264 to eliminate non-recurring expenditures for scuba diving services and pump repairs and a one-time reimbursed expenditure from the Federal Emergency Management Agency of \$6,048 for engineering services. The scuba diving and pump repairs are addressed in the section below.

Depreciation and Amortization

Ohio District reported test period depreciation and amortization expense of \$196,603, which it proposes to increase by \$107,640 to \$304,243 to reflect depreciation expense on the proposed construction projects. The Commission has accepted this adjustment.

After reviewing the expenses recorded as materials and supplies expenses and contractual services expenses, the Commission finds that the following adjustments to depreciation expense are required:

- Capital expenditures for lines and meter installation costing \$1,162 have an estimated useful life of 50 years. This results in additional depreciation expense of \$23.
- Ohio District expended \$1,502 for a tripod with an estimated useful life of 15 years. This expenditure was incorrectly classified as a materials and supplies expense. Correcting this misclassification increases depreciation expense by \$100.
- Ohio District expended the cost of \$19,817 for scuba diving services to clear the water intake structure and \$31,355 for resulting repairs to make its pumps usable. For rate-making purposes this expense should be amortized over the remaining useful life of the pumps, estimated to be 15.5 years. The cost of \$51,172 amortized over 15.5 years results in additional depreciation expense of \$3,301.

These adjustments result in a total increase of \$3,424 to Ohio District's pro forma depreciation expense.

Summary

Based on the above adjustments, Ohio District's test-year operations appear as follows:

	<u>Test Year</u>	<u>Commission Adjustments</u>	<u>Test Year Adjusted</u>
Operating Revenue	\$1,451,178	\$198,456	\$1,649,634
Operating Expenses	<u>1,278,778</u>	<u>(34,089)</u>	<u>1,244,689</u>
Operating Income	\$ 172,400	\$232,545	\$ 404,945
Other Income	73,865	0	\$ 73,865
Other Deductions	<u>211,901</u>	<u>269,000</u>	<u>480,901</u>
Net Income	<u>\$ 34,364</u>	<u>\$(36,455)</u>	<u>\$ (2,091)</u>

REVENUE REQUIREMENTS

The Commission finds Ohio District's annual revenue requirement to be \$1,921,098.¹⁴ To achieve a level of income sufficient to meet its reasonable expenses and debt service, the Commission further finds that Ohio District's rates should be adjusted to produce additional revenues of \$240,844.¹⁵

¹⁴	Adjusted Operating Expenses	\$1,244,689
	Average Annual Debt Service	563,674
	20% Debt Service Coverage	<u>112,735</u>
	Total Revenue Requirement	<u>\$1,921,098</u>

¹⁵	Total Revenue Requirement	\$1,921,098
	Less: Adjusted Operating Revenues	1,649,634
	Unrestricted Interest Income	<u>30,620</u>
	Revenue Increase Required	<u>\$ 240,844</u>

RATE DESIGN

Ohio District proposes to change its current rate design to a 5-step design. The proposed rate structure consists of a minimum usage allowance of 2,000 gallons, a next 18,000 gallons increment, a next 30,000 gallons increment, a next 50,000 gallons increment and an over 100,000 gallons increment. Ohio District's current rate design consists of 3 rate increments: 1) a minimum usage allowance of 2,000 gallons, 2) a next 98,000 gallons increment, and 3) an over 100,000 gallons increment.

Ohio District's proposed change addresses a major concern of the Poultry Association. The Poultry Association has argued that the lack of any rate step between the 2,000 gallon and 100,000 gallon levels adversely affects most small poultry producers, whose average monthly water usage seldom exceeded 100,000 gallons.¹⁶ Ohio District's review of customer water usage patterns confirms that most small poultry producers would fall within the second block of its current rate design.¹⁷ The Commission finds that Ohio District's proposed rate design change is consistent with its current customer usage patterns and should be accepted.

¹⁶ Letter from Kenneth Autry, President, Green River Regional Poultry Producers Association, to Don Mills, Executive Director, Public Service Commission (June 12, 1997).

¹⁷ Case No. 97-423, Ohio District's Response to the Commission's Order of October 21, 1997, Item 7c ("For two houses (minimum size) average use is approximately 50,000 to 60,000 gallons per month."). See also Case No. 98-015, Ohio District's Application, Exhibit E.

The Poultry Association proposes the establishment of a special contract rate for poultry producers and other large users.¹⁸ The record, however, lacks any evidence to support such action. The Poultry Association has offered no evidence to support the contention that poultry producers' water usage characteristics differ so greatly from other water users or impose a unique set of costs upon Ohio District to serve them. In the absence of such evidence, a special contract rate is inappropriate.

Using an updated edition of the cost of service study prepared by Commission Staff in Ohio District's last rate case¹⁹ and Ohio District's proposed rate design, the Commission has developed the rates set out in Appendix A. Ohio District proposes to increase its wholesale rate from \$1.10 to \$1.50 per 1,000 gallons. In Case No. 95-459, the results of Commission Staff's cost of service study showed that Ohio District's wholesale rate should be decreased from \$1.10 to \$1.08 per 1,000 gallons. Stating that no change in the wholesale rate would also minimize the necessity for future rate increases, Ohio District requested that the rate be left undisturbed. The updated cost of service study in the present case continues to show that the wholesale rate should be left undisturbed. Absent any substantial evidence to support a different result, the Commission finds that Ohio

¹⁸ Case No. 97-423, Ohio District's Response to the Commission's Order of October 21, 1997, Item 2 at 5; Letter from Kenneth Autry, President, Green River Regional Poultry Producers Association, to Public Service Commission (February 6, 1998).

¹⁹ Case No. 95-459, The Application of Ohio County Water District for (1) Authority to Assume Ownership, Operation and Maintenance of Rough River Water System, Inc. (2) Authority to Make General Adjustments in the Current Rates and (3) Authority to Increase the Current Connection Fees, (January 27, 1997) (establishing new rates for service).

District's proposal to change the wholesale rate should be denied and that the wholesale rate should remain at \$1.10 per 1,000 gallons.

"FREE WATER"

Throughout these proceedings, Ohio District and the Poultry Association have referred to Perdue Farms' allocation of 1 MGD of water as "free water." The use of the phrase "free water" is a misnomer. To obtain the water, Ohio District must make significant expenditures. It must construct facilities costing \$720,000 to obtain and chemically treat water from Perdue Farms. As part of its unwritten agreement with Ohio County Fiscal Court, which under an economic development agreement with Perdue Farms is the actual owner of the 1 MGD capacity, Ohio District has agreed to undertake \$1.42 million of water main extension projects.²⁰ Ohio County Fiscal Court has agreed to contribute \$700,000 over the next 20 years for these water main extension projects. Ohio District's own analyses²¹ indicate that the benefit of the 1 MGD of water capacity and of the Ohio County Fiscal Court contribution is \$1,910,000 and their corresponding cost is \$1,424,200.

While Ohio District will benefit from these transactions, the Commission is concerned about the absence of any contractual commitments. No contract exists between Ohio District and Ohio County Fiscal Court for the transfer of the 1 MGD water capacity to Ohio District. Similarly, Ohio County Fiscal Court's commitment to contribute \$700,000 is not evidenced by any written agreement nor has any timetable been

²⁰ Ohio District's Response to the Commission's Order of May 8, 1998 ("Exhibit P"), Item 16, at 36.

²¹ Id.

established for the payment of this contribution. In light of Ohio District's expenditures, the Commission strongly encourages Ohio District to obtain written legally enforceable agreements with Ohio County Fiscal Court on these matters.

SUMMARY

After review of the evidence of the record and being otherwise sufficiently advised, the Commission finds that:

1. Public convenience and necessity require the construction of the facilities and improvements identified in Ohio District's application as Series I Contracts.

2. The proposed issuance of \$4.0 million in revenue bonds is for the lawful objects within Ohio District's corporate purposes, is necessary and appropriate for and consistent with the proper performance by Ohio District of its service to the public and will not impair its ability to perform that service.

3. The rates in Appendix A to this Order are the fair, just, and reasonable rates for Ohio District and will produce annual revenue from rates of \$1,840,823 based on adjusted test-year sales.

4. The rates proposed by Ohio District are unjust and unreasonable and should be denied.

IT IS THEREFORE ORDERED that:

1. Ohio District is granted a Certificate of Public Convenience and Necessity to proceed with the proposed construction project as set forth in the drawings and specifications of record herein.

2. Ohio District shall monitor the adequacies of the expanded water distribution system after construction. If the level of service is inadequate or declining or the pressure to any customer is outside the requirements of 807 KAR 5:066, Section 5(1), Ohio District shall take immediate action to maintain the level of service in conformance with the regulations of the Commission.

3. Ohio District shall obtain approval from the Commission prior to performing any additional construction not expressly authorized by this Order.

4. Any deviation from the construction approved shall be undertaken only with the prior approval of the Commission.

5. Within 10 days of the opening of bids for Contracts E and F but no later than September 1, 1998, Ohio District shall file with the Commission the final bids for Contracts E and F and shall identify in writing the selected bid and the reasons for its selection.

6. Ohio District shall furnish documentation of the total costs of these projects including the cost of construction and all other capitalized costs (e.g., engineering, legal, administrative) within 60 days of the date that construction is substantially completed. Construction costs shall be classified into appropriate plant accounts in accordance with the Uniform System of Accounts for Water Utilities prescribed by the Commission.

7. Ohio District shall require the proposed construction to be inspected under the general supervision of a professional engineer with a Kentucky registration in civil or mechanical engineering, to ensure that the construction work is in accordance with the contract drawings and specifications and conforms with the best practices of the construction trades involved in the project.

8. Ohio District shall furnish, within 60 days of the date of substantial completion of this construction, a copy of the "as-built" drawings and a sworn affidavit that the construction has been satisfactorily completed in accordance with the contract plans and specifications.

9. Ohio District is authorized to issue revenue bonds in the principal amount not to exceed \$4.0 million at an interest rate not to exceed 6 percent and at an average issuance rate not to exceed 5.75 percent. The proceeds of this issuance shall be used only for the lawful purposes specified in Ohio District's application.

10. Within 30 days of the date of the issuance of the proposed revenue bonds, Ohio District shall advise the Commission in writing of the date or dates of issuance of the revenue bonds, the price paid, the interest rate, the purchasers, and all fees and expenses, including underwriting discounts or commissions, or other compensation involved in the issuance and distribution.

11. The rates set forth in Appendix A are approved for service rendered by Ohio District on and after the date of this Order.

12. The rates proposed by Ohio District are denied.

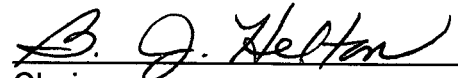
13. Within 30 days of the date of this Order, Ohio District shall file revised tariff sheets reflecting the rates approved herein.

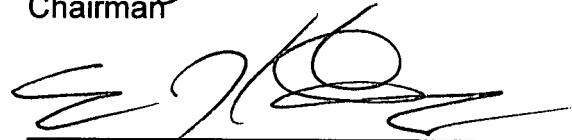
14. Nothing contained herein shall be considered as Commission approval of Ohio District's proposed Series II or Series III Improvement Projects.

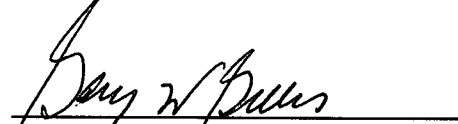
Nothing contained herein shall be deemed a warranty or finding of value of securities or financing authorized herein on the part of the Commonwealth of Kentucky or any agency thereof.

Done at Frankfort, Kentucky, this 19th day of August, 1998.

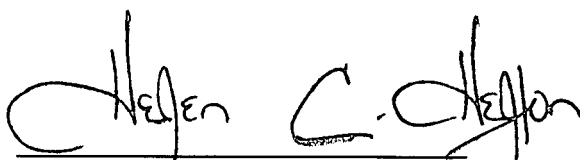
PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 98-015 DATED AUGUST 19, 1998

The following rates and charges are prescribed for the customers in the area served by the Ohio County Water District. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

MONTHLY RATES

First	2,000 Gallons	\$13.50	Minimum Bill
Next	18,000 Gallons	5.10	Per 1,000 Gallons
Next	30,000 Gallons	4.48	Per 1,000 Gallons
Next	50,000 Gallons	3.81	Per 1,000 Gallons
Over	100,000 Gallons	3.13	Per 1,000 Gallons
Wholesale Rate		\$1.10	Per 1,000 Gallons